

## Introduction

The hospTrends Featured Topic this quarter is a discussion of operating and non-operating income during the recent economic upheaval. The Featured Topic is a financial or utilization category that is given a slightly longer explanation. hospTRENDS reviews the current plus previous 12 quarters, which equals three years plus one quarter. To be consistent we use quarterly data for the entire period even though actual fiscal year end data is available through 2008 for most facilities. Our web site information and a short description of the data we have available are at the end of the report.

## Quarterly Quick Review

Below is a summary table of the statewide trends. The total number of discharges by period increased 2.9%. For the previous five periods, however, the increase was below 2.0%. Between the periods beginning third quarter 2002 and ending fourth quarter 2004 increases were between 0.38% and 1.68%. Patient days have grown 4.67% in this period. The previous high in recent years was 3.66% for the period ending December 31, 2005 and smaller increases for the next two periods. Average length of stay increased to 4.36, the highest value since the ending December 31, 2003.

Deductions from revenue grew at a 14.6% rate, continuing a cycle where the growth in deductions had been slightly smaller each period from 2003 until the fourth quarter of 2006. The operating revenue grew slightly slower (10.4%) than operating expenses (10.55%) which translates into a modest operating margin increase of 2.3% over the previous period. Operating expense grew by 10.55%, which is within the annual percentage change range of the past 10 years that includes a low of 7.5% and a high of 10.9%. Charity care grew at 11.46% compared to recent growth of up to 81.2%. Bad debt continued recent trends with an increase of 6.31%. Both charity care and bad debt have seen decreasing rates of change in the past five periods.

## Statewide Summary of Quarterly Reports

	4 Quarter Period Ending		Percent	2008
	12/31/2007	12/31/2008	Difference	Percent of Tot Rev
Discharges	562,784	579,106	2.9%	
Patient Days	2,413,853	2,526,518	4.7%	
Average Length of Stay	4.29	4.36	1.7%	
+ Total Revenue	27,495,565,635	31,072,071,747	13.0%	
- Deductions from Revenue	15,281,836,525	17,509,064,204	14.6%	56.3%
= Net Revenue	12,213,729,110	13,563,007,543	11.0%	43.7%
+ Other Operating Revenue	819,936,224	828,090,719	1.0%	2.7%
= Operating Revenue	13,033,665,334	14,391,098,262	10.4%	46.3%
- Operating Expenses	12,381,077,038	13,687,620,902	10.6%	44.1%
= Operating Margin	652,588,296	703,477,360	7.8%	2.3%
+ Other Income/Tax Revenue	296,318,426	(220,770,234)	-174.5%	-0.7%
= Total Margin	948,906,722	482,707,126	-49.1%	1.6%
Charity Care	610,801,895	680,785,931	11.5%	2.2%
Bad Debt	634,374,772	674,413,170	6.3%	2.2%
Operating Margin	4.99	4.87	-2.4%	
Total Margin	7.10	3.39	-52.3%	

## Featured Topic

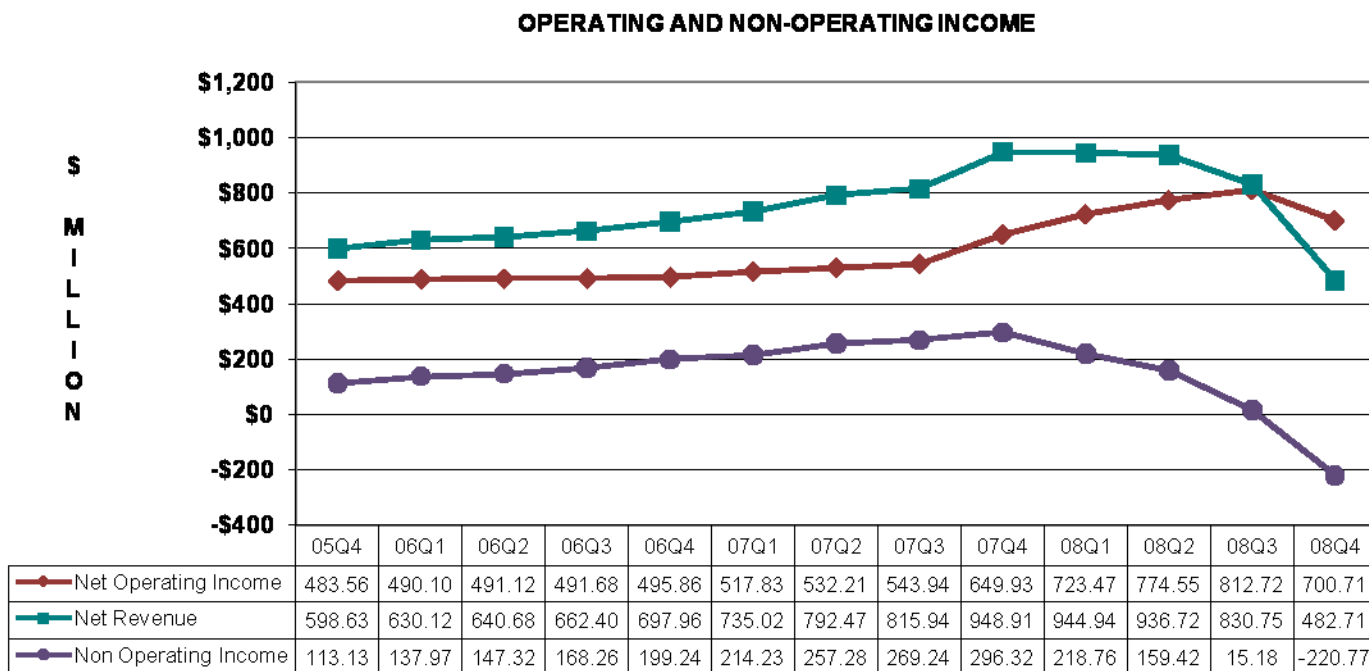
### A continuation of last quarter's discussion of non-operating income trends

The business of providing care to patients is only one component of the income a hospital earns. Other activities, such as sales of hospital assets, medical office rental, tax income (for district hospitals), donations and investment gains or losses all contribute to a hospital's net income. As the overall US economy began to falter in late 2007 through 2008, hospitals in Washington saw their income from these sources begin to decline for the first time in several years. Net non-operating income in Washington had increased 293% or over \$221 million during the four and one quarter years between the year ending September 30, 2003 and the year ending December 31, 2007. That growth trend reversed itself and net non-operating income plummeted to slightly more than \$15 million for the year ending September 30, 2008, a decline of over \$281 million, or 94.9%. In the year ending December 31, 2008, that declining net non-operating income became a net loss of over \$220 million. This is the first net non-operating loss on a statewide basis since the Department began collecting this value in its quarterly reports in 2000.

Accounting rules require changes in the values of assets such as the securities and real estate that may make up hospitals' investments to be reported as increases or decreases in income, regardless of whether those assets have actually been sold for a profit or a loss. As a result, the current drop in non-operating income may be the result of changes in value of assets still owned by the hospitals, or it may reflect losses incurred by selling assets such as securities or real estate for less than they were previously valued. If these losses are not realized by selling the underlying assets and the value of those assets recovers in the future, we can expect to see gains in net non-operating income to follow.

In the last quarter's analysis we noted that as net non-operating income fell, net operating income climbed sharply. In the current period, net operating income declined, but still showed an increase over the twelve months ending December 31, 2007, of 7.8%.

### Operating and Non-Operating Income

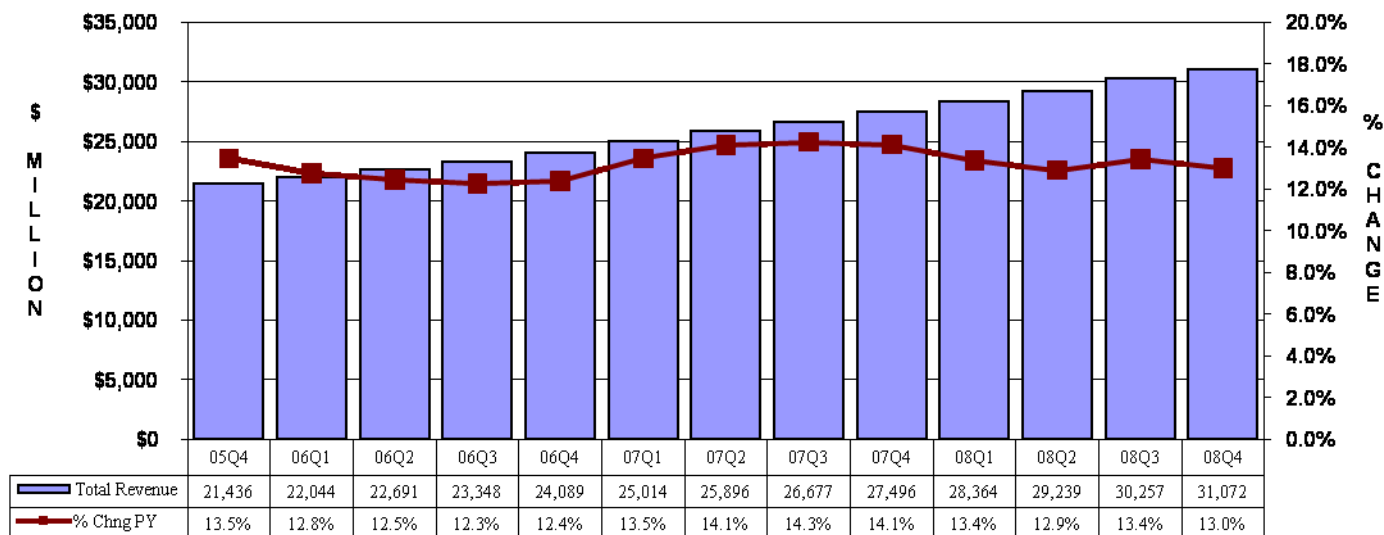


## FINANCIAL INDICATORS

### Total Patient Service Revenue

Total billed charges for patient services, which are identified as total patient service revenue or total revenue, increased by \$3.6 billion from \$27.5 billion to \$31.1 billion for the period ending December 31, 2008. The annual increase rate of 13.0% is similar to recent rates. The annual dollar increase had been between \$2.05 and \$2.55 billion each four-quarter year for sixteen periods, but has now advanced to over \$3 billion in each of the last five periods. The billed charges are based on common billing charge sheets that the hospital uses for all patients regardless of the payer and regardless of any contractual adjustments.

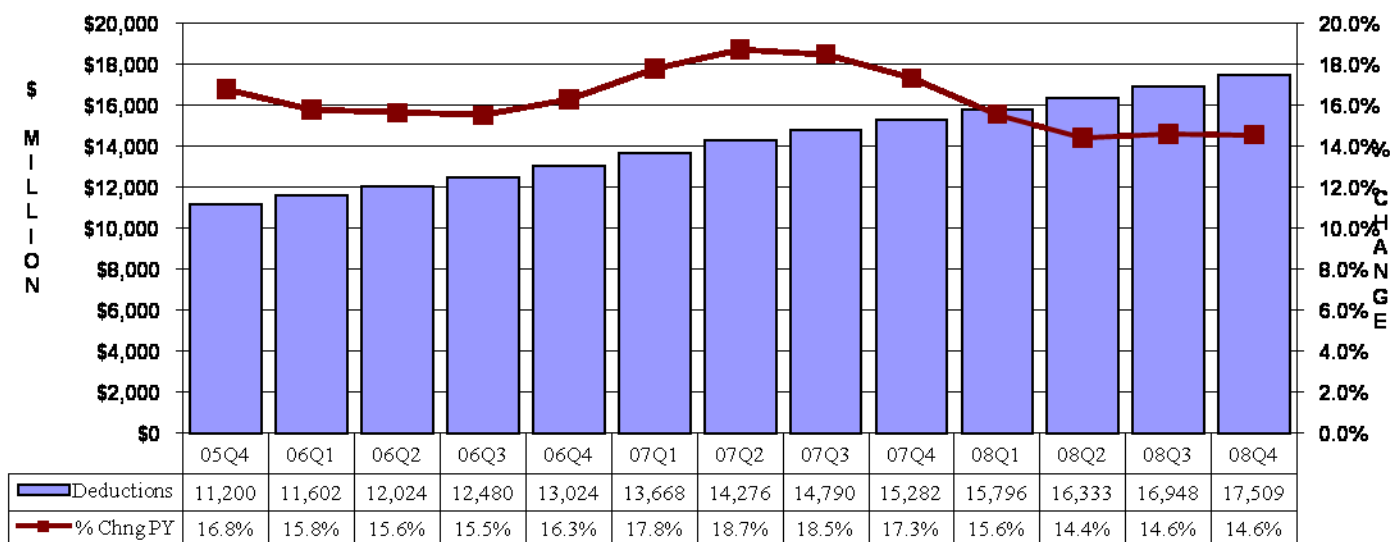
### Total Patient Service Revenue



### Total Deductions from Revenue

For the twelve months ended December 31, 2008 total deductions from revenue reached \$17.5 billion. This was an increase of \$2.2 billion, or 14.6% over the previous period ending December 31, 2007. Total deductions from revenue have been more than 50% of total patient service revenue since the four quarters ending September 2004. Total deductions include contractual adjustments and charity care. Deductions are the difference between what the hospital billed and what they were paid.

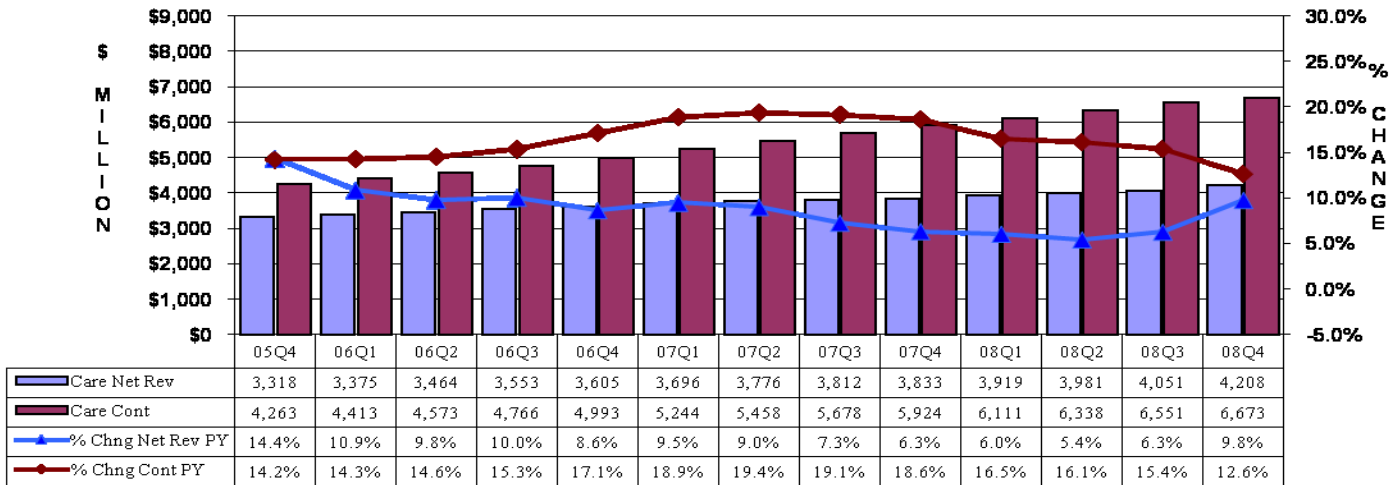
### Total Deductions from Revenue



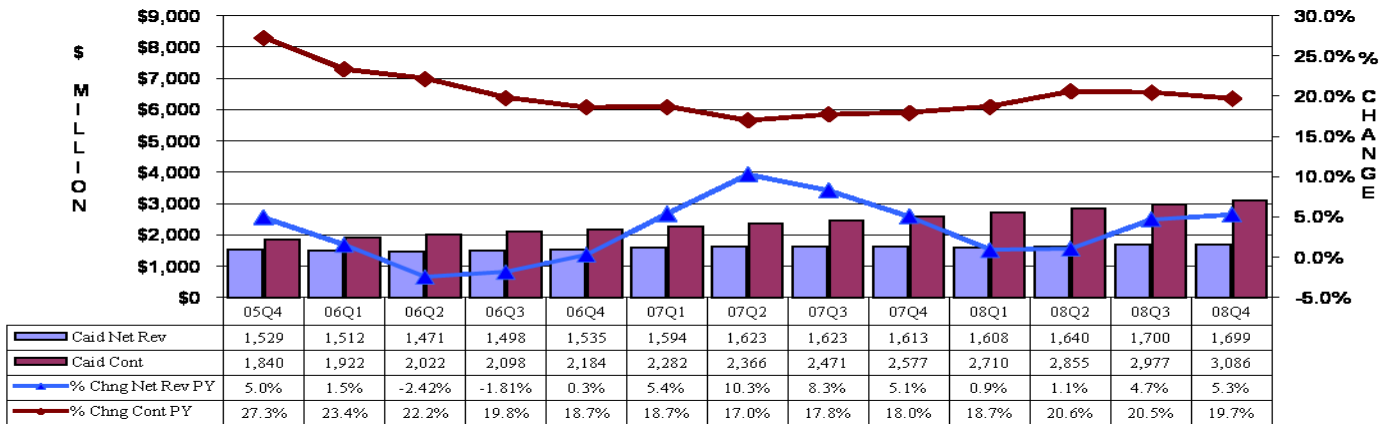
## Contractual Adjustments

Contractuals, the most significant part of deductions from revenue, vary by payer. Below are three graphs, one for each payer, Medicare, Medicaid and other. The three graphs are set up so you can see the relative size of the contractual adjustments and the net revenue by payer. The chart shows net revenue and contractuals and the percentage change for each over the prior year period. Other payer has the largest portion of net revenue, \$8.34 billion and deductions of \$7.07 billion. Medicare's net revenue of \$4.21 billion is much less than other however the contractuals are similar to other at \$6.67 billion. Medicaid net revenue was \$1.70 billion and deductions were \$3.09 billion. Based on the hospital's rate sheet, or billed revenue, hospitals bill Medicare an average of \$3.11 for each dollar they receive, other payers an average of \$1.85 and Medicaid an average of \$2.82.

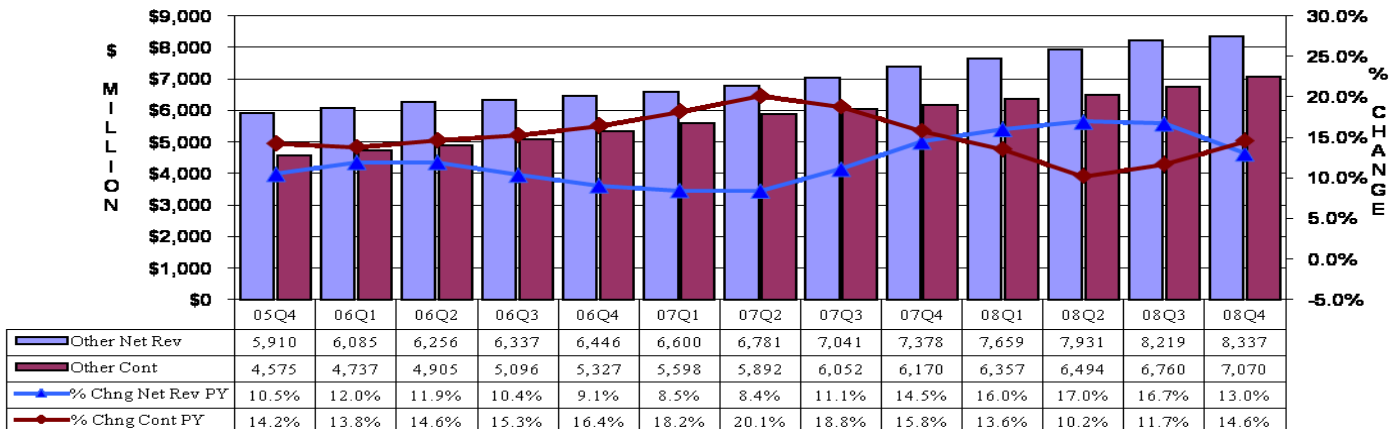
### Medicare Contractuals



### Medicaid Contractuals



### Other Contractuals



## Uncompensated Care

Uncompensated care is composed of charity care and bad debt expense. While charity care is part of the deductions from revenue category and bad debt is part of the operating expenses, they are similar. Each represents billed charges for hospital services that are not paid. Charity care represents charges that are not paid by patients who are **unable** to pay, while bad debt expense arises from charges that are not paid by patients who are **unwilling** to pay. During this four-quarter cycle, charity care has grown by 11.5% and bad debt has increased by 6.3%, for a total increase in uncompensated care of 8.5%.

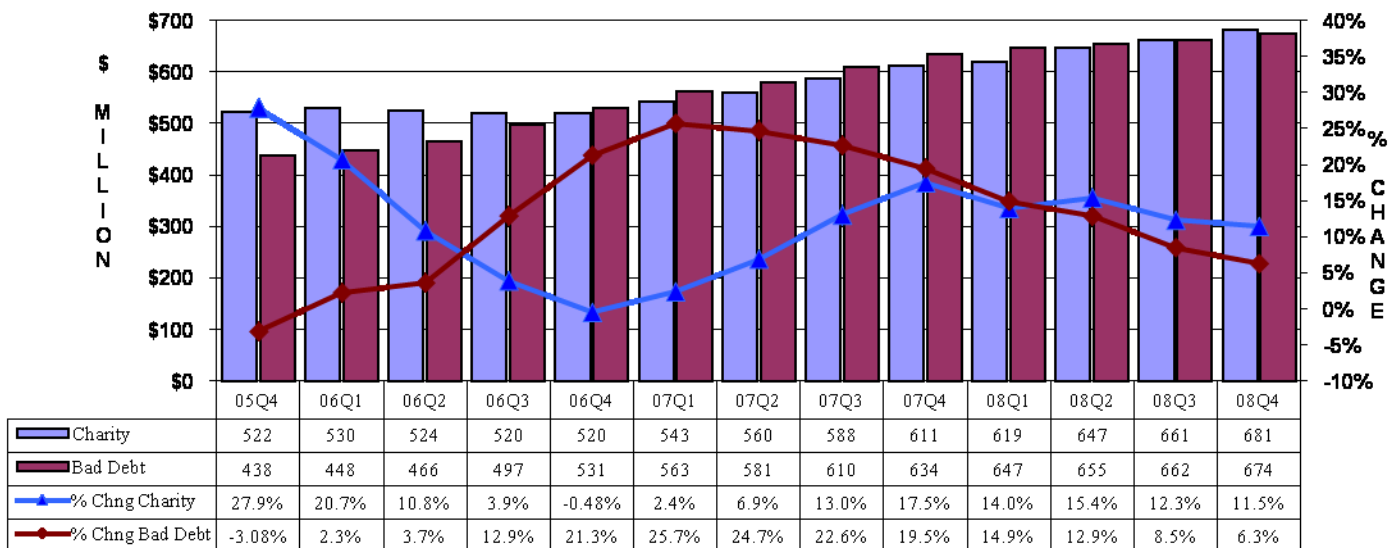
### Charity

While charity care is only 2.19% of billed revenue, the dollar amount and percentage have been growing very rapidly during the past five years. Recently, during the December 31, 2007 to December 31, 2008 period, charity care has increased 11.5% or \$70 million.

### Bad Debt

The bad debt dollar amount has grown from \$634 million for the four quarters ending December 31, 2007 to \$674 million for the period ending December 31, 2008, which is a 6.3% increase. Bad debt has been slowing its rate of increase since the four quarters ending December 31, 2005.

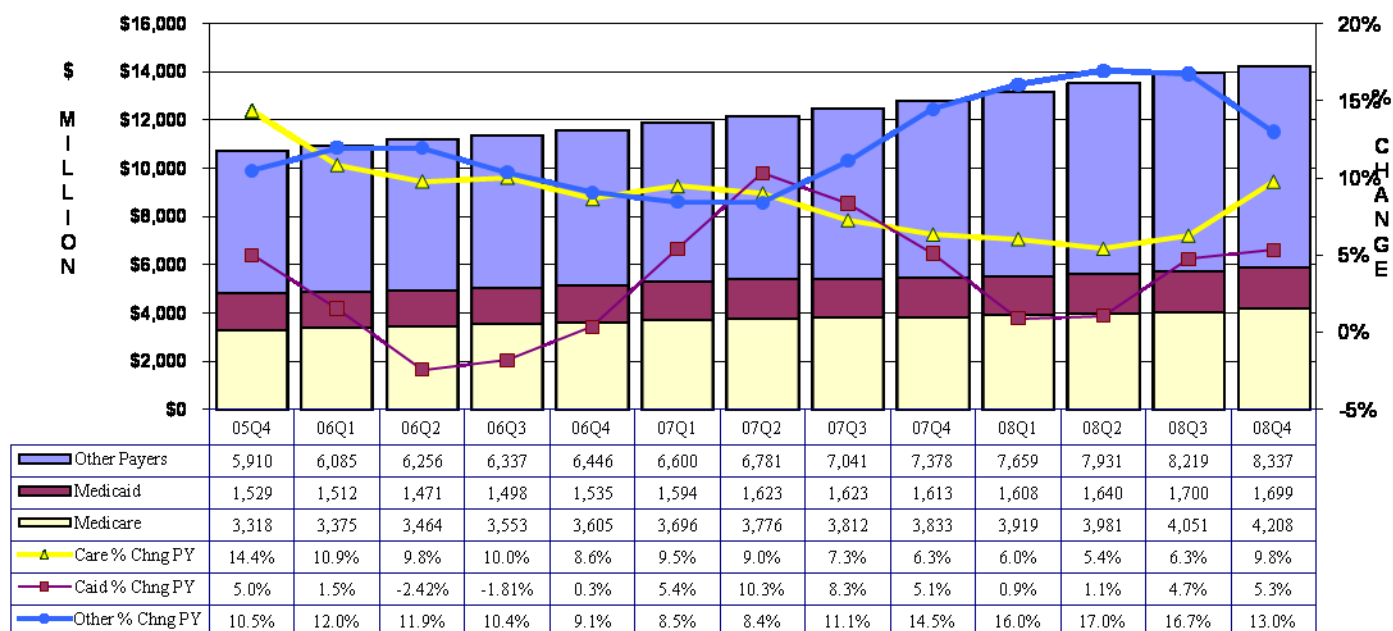
### Charity and Bad Debt



## Net Patient Services Revenue

During the twelve-month period ended December 31, 2008, net patient service revenue grew by 11.05%, or \$1.4 billion, from \$12.2 billion to \$13.6 billion. Other payer continues its strong percentage and dollar growth (13%, \$959 million). The percentage change by payer from the previous year period shows that Medicare had a 9.8% increase and other had a 13.0% increase over the twelve month period ending December 31, 2007. Medicaid revenue increased 14.2% while Medicaid deductions increased by 19.7%, increasing the net patient service revenue for Medicaid by 5.3% from the previous period.

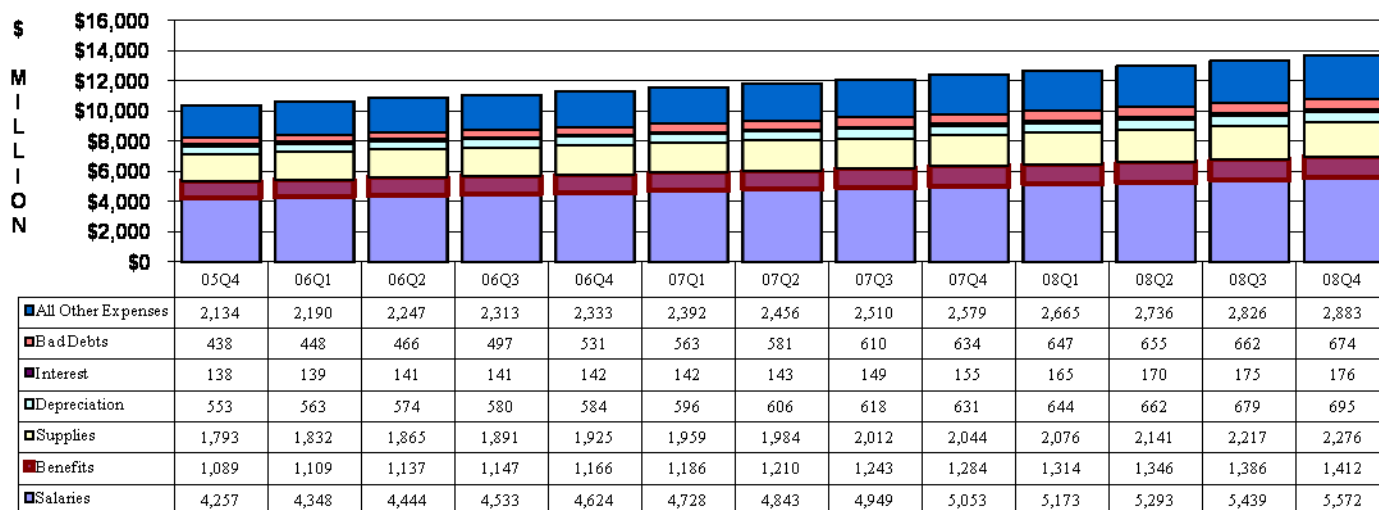
## Net Patient Service Revenue by Payer



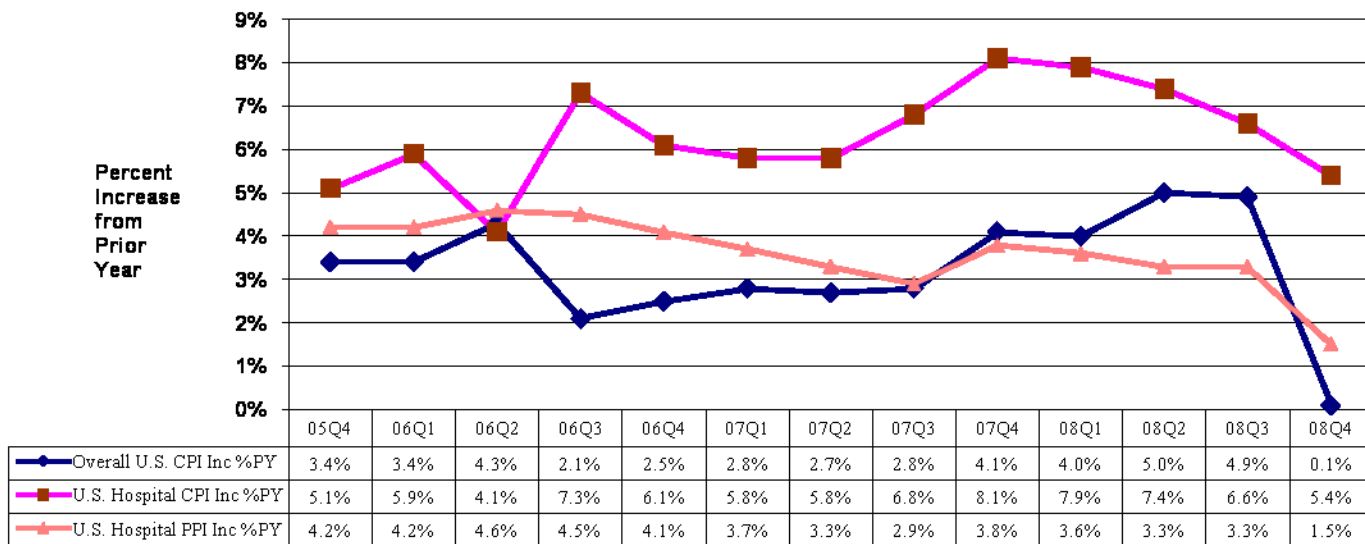
## Operating Expenses

Operating expenses are the costs of providing health care services to hospital patients. Growing by 10.6%, or \$1.31 billion, operating expenses reached \$12.4 billion in the twelve-month period ended December 31, 2008. Adjusted discharges only increased 2.11% during the same period. Operating expenses per adjusted discharge increased by 8.27%. The 8.27% increase exceeded the 0.1% annual increase in the overall United States consumer price index as well as the 5.4% annual increase in the United States hospital services component of the index for the same period of December 2007 to December 2008. The category with the largest dollar increase in operating expenses was salaries at 10.3% or \$519 million for a total of \$5,439 million. The category with the largest percentage increase in operating expenses was interest expense at 13.3%, or \$21 million for a total of \$176 million. Despite having the largest percentage increase, Interest expense had the smallest dollar increases during the same period, while bad debt had the smallest percentage increase.

## Operating Expense



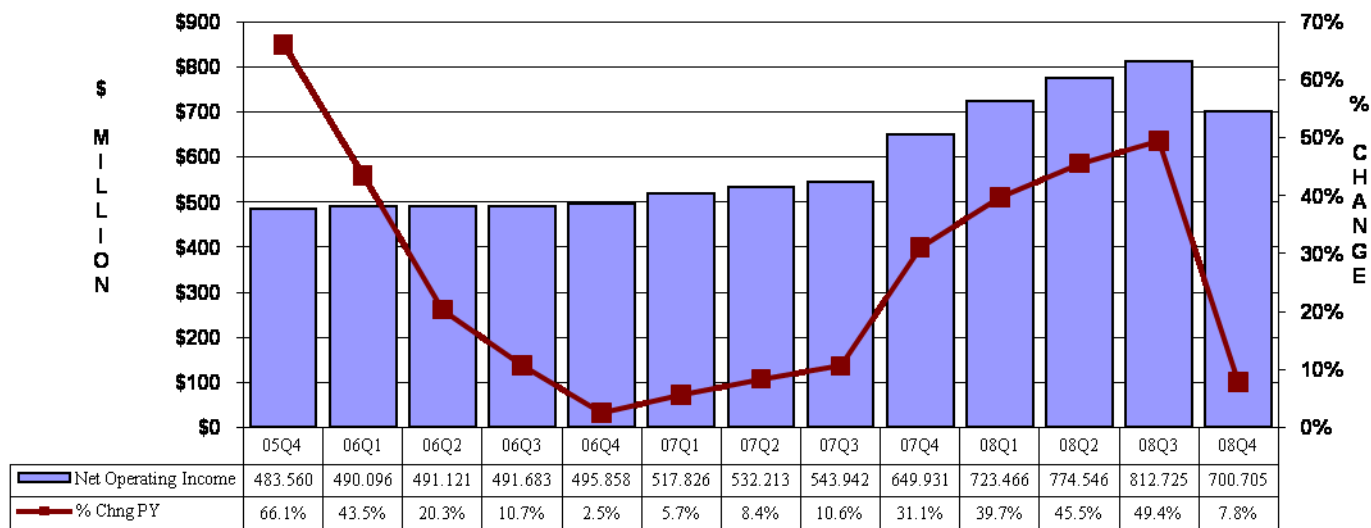
## United States Consumer Price Index and Produce Price Index change from previous year (Overall vs. Hospital)



### Net Operating Income

During the four quarters ended December 31, 2008 net operating income equaled \$701 million, which was up 7.8% over the year ago level. This is the lowest rate of growth since the year ending March 31, 2007. Net operating income is volatile due to the large dollars that are involved in the calculation. A small change in the ratio of operating income, which grew 10.41% and operating expense, which grew 10.55%, caused the 7.8% change in net operating income. Net operating income includes other operating income.

### Net Operating Income



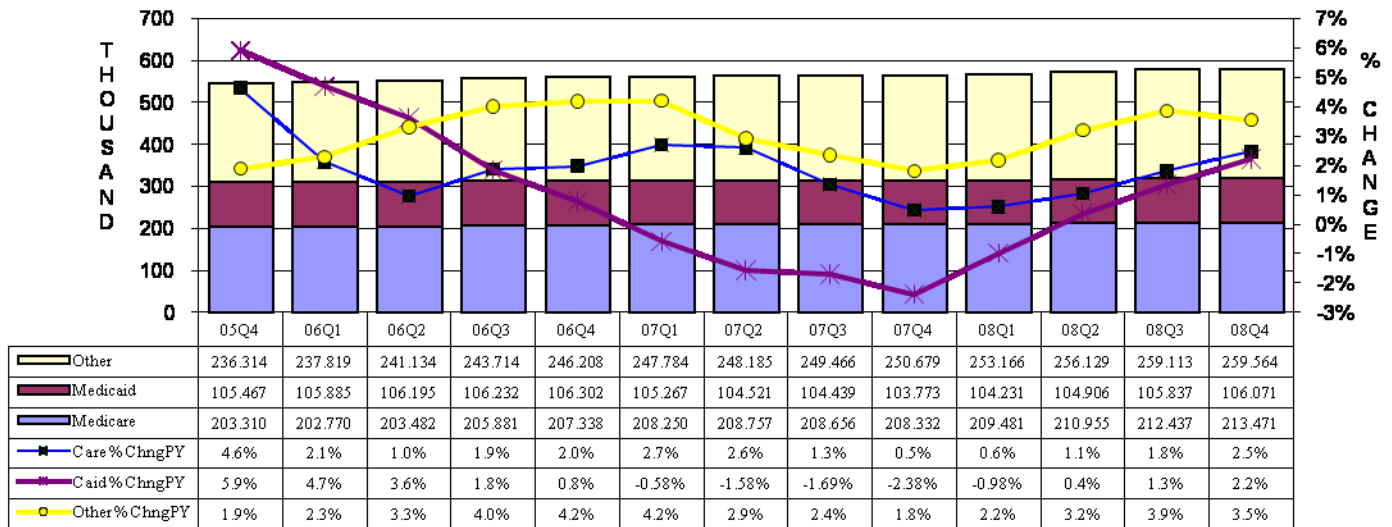


## UTILIZATION INDICATORS

### Discharges

Discharges and patient days are the primary indicators of inpatient activity. Discharges continued to grow slowly, reaching 579,106 discharges during the four quarters ending December 31, 2008. This was a gain of 16,322 discharges, or 2.9%, over the corresponding 2007 period. Medicaid discharges increased 2.2%, while Medicare discharges increased 2.58% and other discharges increased 3.5%.

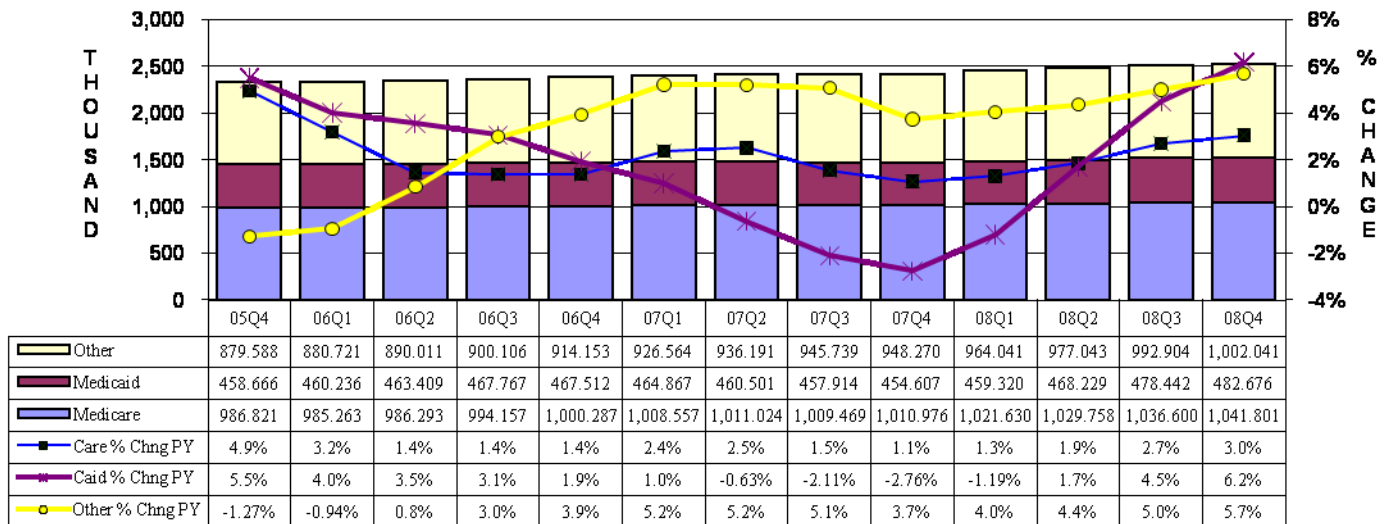
#### Discharges by Payer



### Patient Days

Patient days also continued to grow modestly, reaching 2,526,518 during the four quarters ending December 31, 2008. This was a gain of 112,665 patient days, or 4.67%, over the corresponding year ago period. Medicare days grew 3.0%, Medicaid days increased 6.2% and other increased by 5.7%.

#### Patient Days by Payer

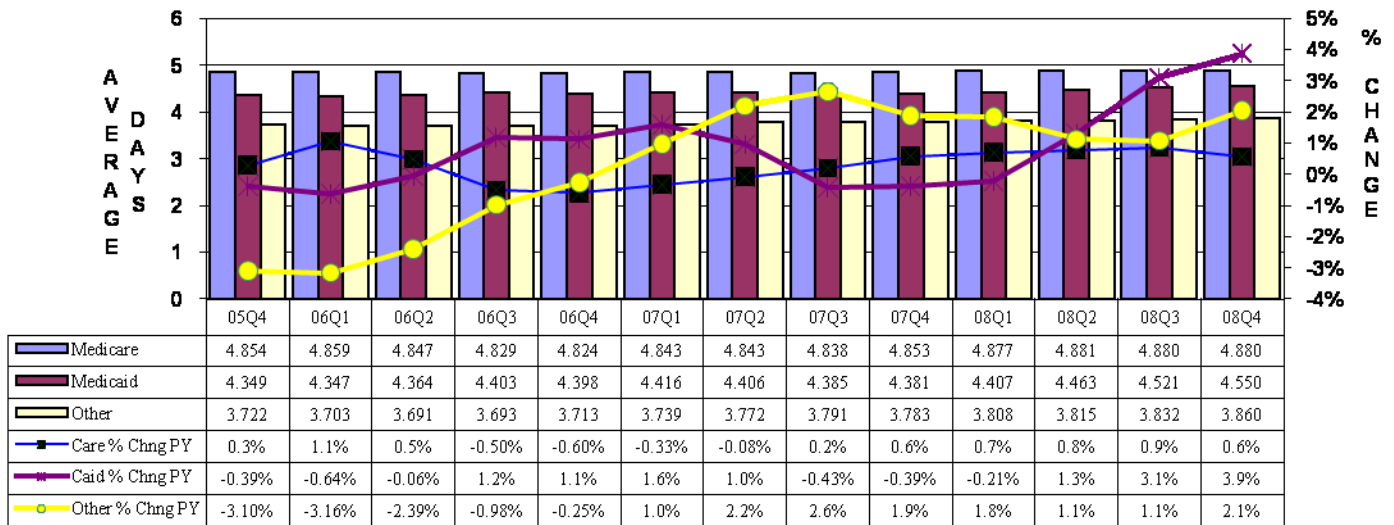




## Length of Stay

Since the percentage increase in statewide discharges during the four quarters ending December 2008 was less than the increase of patient days, statewide average length of stay increased slightly to 4.36 days, or 1.72%. Statewide average length of stay (ALOS) had remained in the range of 4.37 days to 4.24 days from calendar year 1995 through second quarter 2006. During the four quarters ended December 31, 2008, the average length of stay has increased by 0.07 days from the previous period ending December 31, 2007. In the latest period, Medicare average length of stay was 4.88, Medicaid was 4.55 and other was 3.86. Medicare ALOS was 7.2% higher than Medicaid and 26.4% higher than Other Payer.

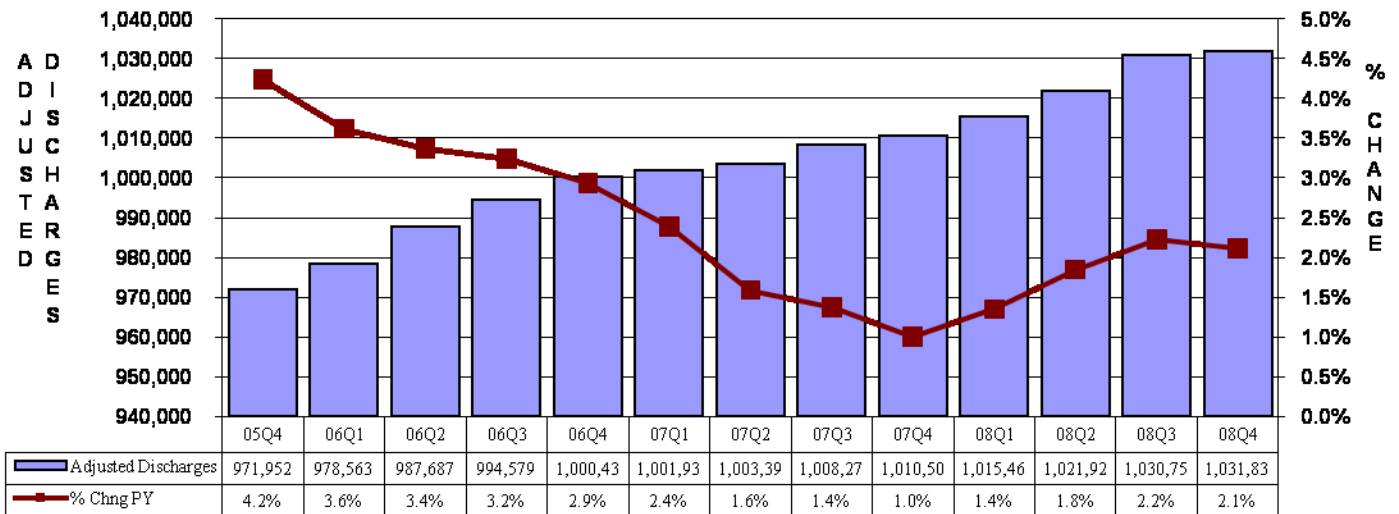
## Length of Stay by Payer



## Adjusted Discharges

Adjusted discharges reached 1,031,834 in the four-quarter period ended December 31, 2008. This was an increase of 21,333 adjusted discharges, or 2.1%, from the four-quarter period ended December 31, 2007. Adjusted discharges were created as a proxy for total hospital volume since discharges only count inpatients. Adjusted discharges, within the quarterly system, are calculated by increasing discharges by the percent of inpatient revenue to total revenue.

## Adjusted Discharges

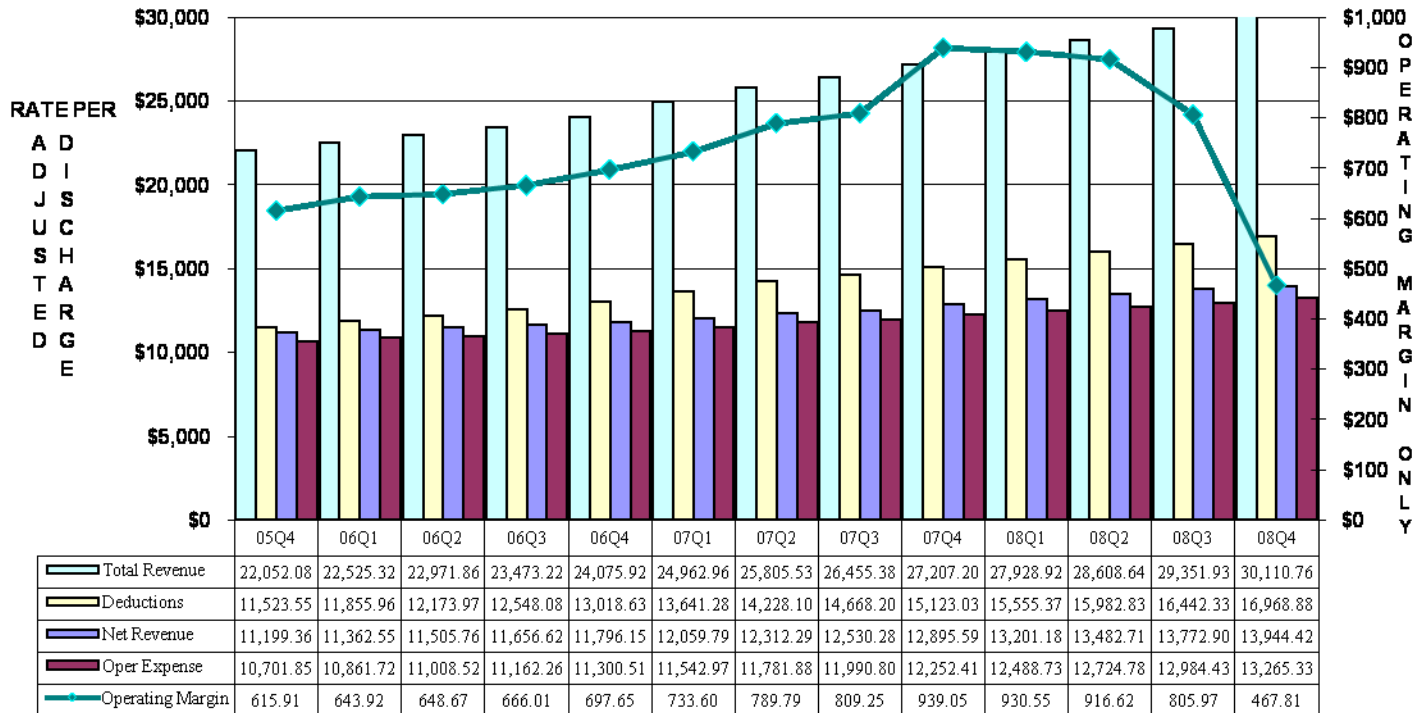


## OPERATING INDICATORS

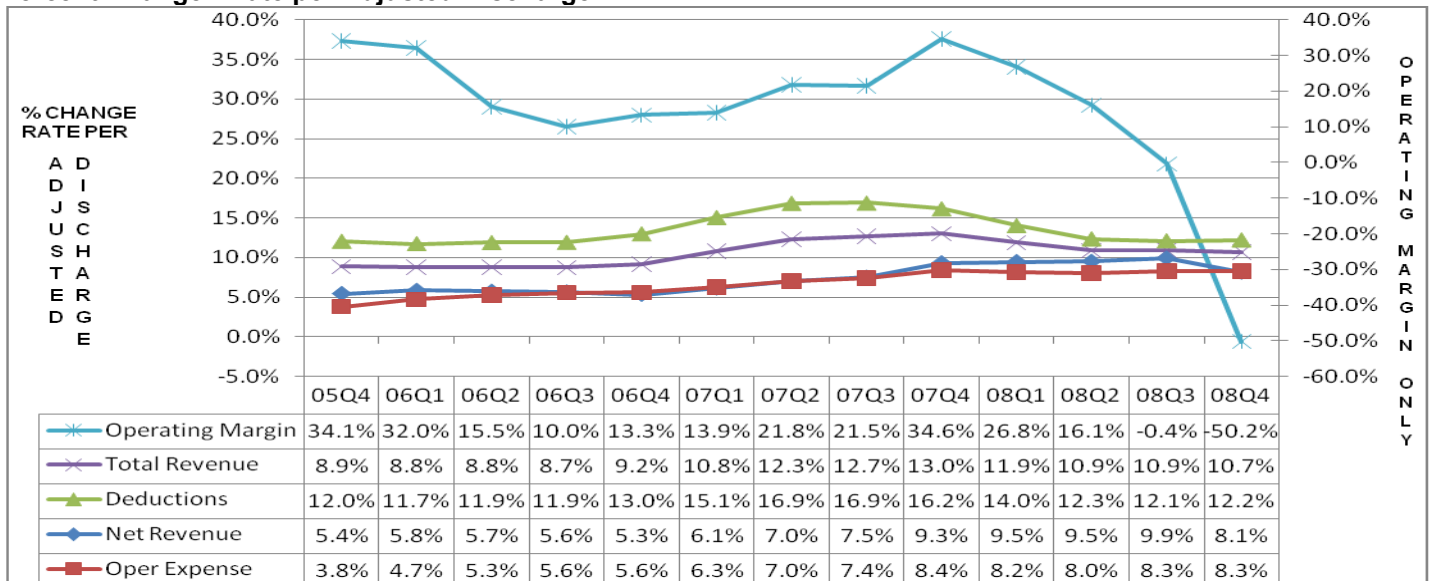
### Rates per Adjusted Discharge

When the total dollar amounts for various categories are divided by the adjusted discharge count, the result is an average rate per adjusted discharge. This formula removes volume fluctuation from the review and makes it easier to look at other factors. Total or billed revenue is becoming less relevant each year, as it is now more than twice the actual dollar amount collected. Of note this quarter, while total revenue, net revenue, deductions and operating expense each grew between 8.1% and 12.2% over the previous twelve months, operating margin per adjusted discharge declined a dramatic 50.2% below the previous year's value. This is the largest decline in this value in recent history.

### Rate per Adjusted Discharge



### Percent Change - Rate per Adjusted Discharge



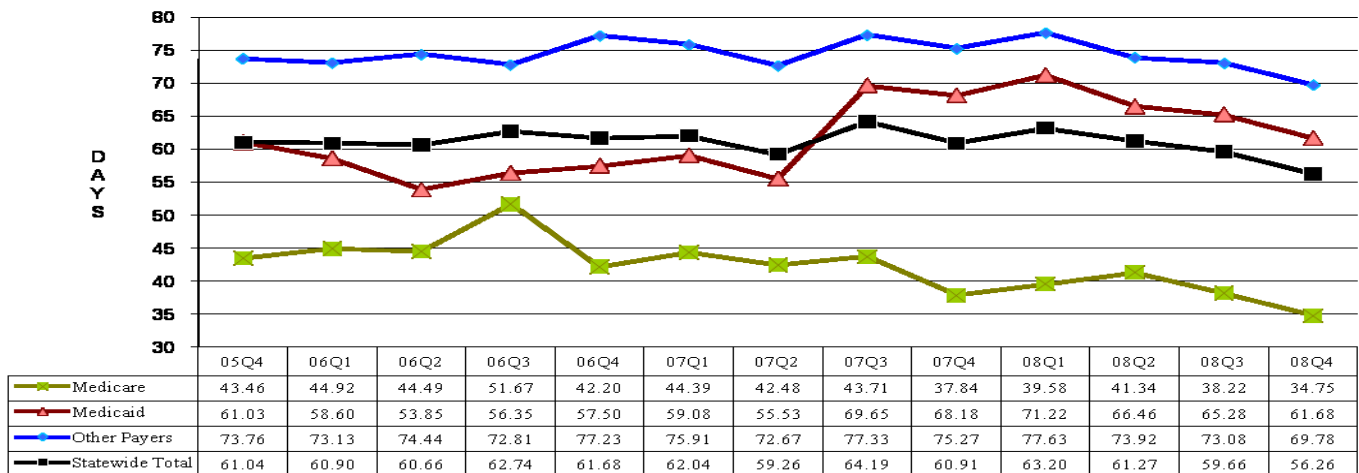
## FINANCIAL RATIOS

The relationships between financial indicators are reflected by financial ratios. The financial ratios selected for this report are not all encompassing, but represent financial indicators that can be readily calculated from the data available through the quarterly reporting process as currently designed without requesting supplemental data from the reporting hospitals.

### Days in Accounts Receivable

Accounts receivable is the largest item in the current assets portion of the balance sheet for most hospitals. Days in accounts receivable is a measure of how "current" this asset is. In this report days in accounts receivable is calculated on an annual gross basis. Shorter days or smaller numbers are more desirable. On a statewide basis, accounts receivable averaged 56.3 days for the four-quarter period ending December 31, 2008. This was decrease of 4.6 days, or 7.58%, from the corresponding year earlier period. Medicare accounts receivable decreased by 3.1 days, or 8.17%, to 34.8 days. Accounts receivable for Medicaid decreased by 6.5 days, or 9.53%, to 61.7 days. A decrease of 5.5 days, or 7.29%, to an average of 69.8 days was also noted for the other payer groups.

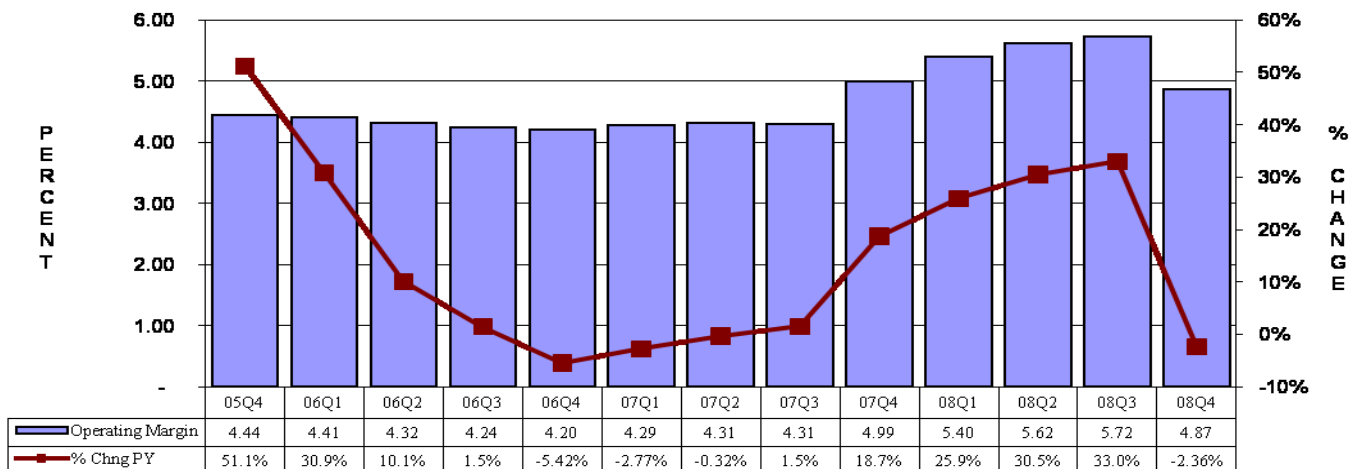
### Days in Accounts Receivable by Payer



### Operating Margin

During the twelve-month period ended December 31, 2008, operating margin declined to 4.87%, which was 2.36% below the year earlier level. The current period is significantly lower than the previous three periods, but is not low by historical standards. Operating margin includes patient revenue and other operating revenue.

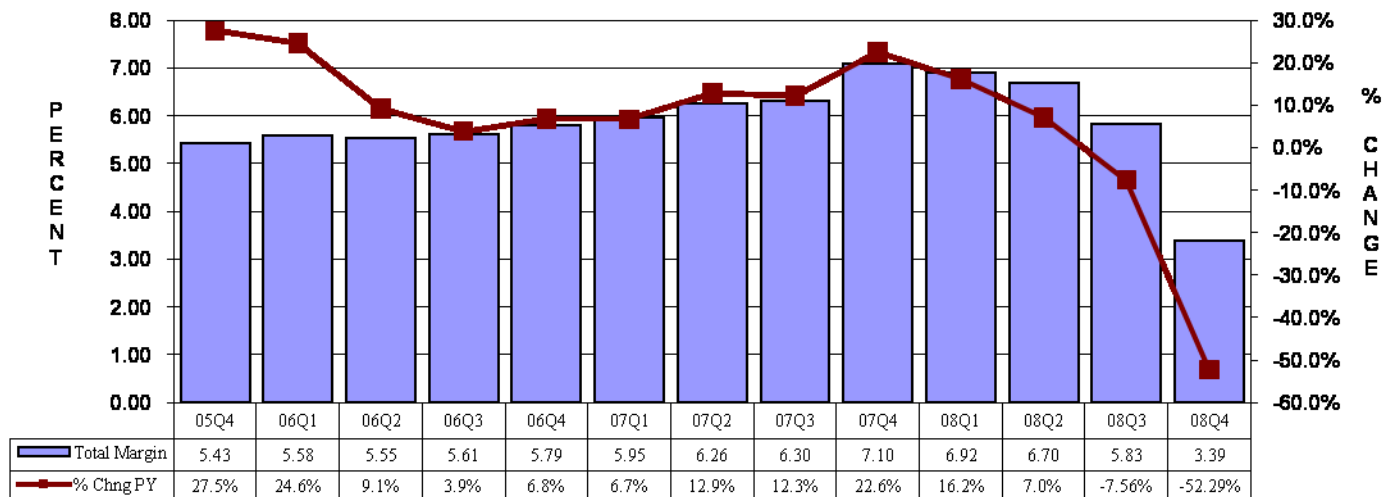
### Operating Margin



## Total Margin

During the twelve-month period ending December 31, 2008 total margin declined to 3.39%, which was 52.29% below the year earlier level. This is the second decline since the year ending March 31, 2005. Total margin includes operating margin plus extraordinary items, federal income taxes and non-operating income.

### Total Margin



## Deductible Proportion

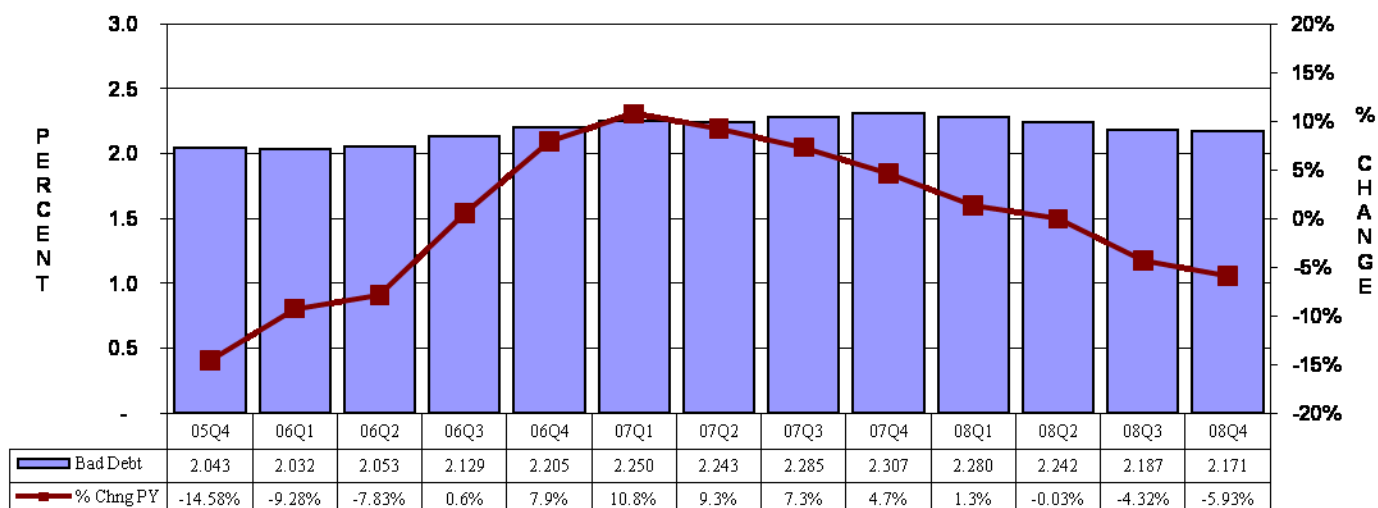
### Uncompensated Care Proportion

The bad debt proportion, charity proportion, and total uncompensated care proportion, compare bad debt expense, charity care and total uncompensated care to total patient service revenue. The total uncompensated care proportion was 4.36%, which was a decrease of 3.69% from the previous year.

### Bad Debt

In the four quarter period ended December 31, 2008, the bad debt proportion reached 2.17%, which was a decline of 5.93% from the previous year.

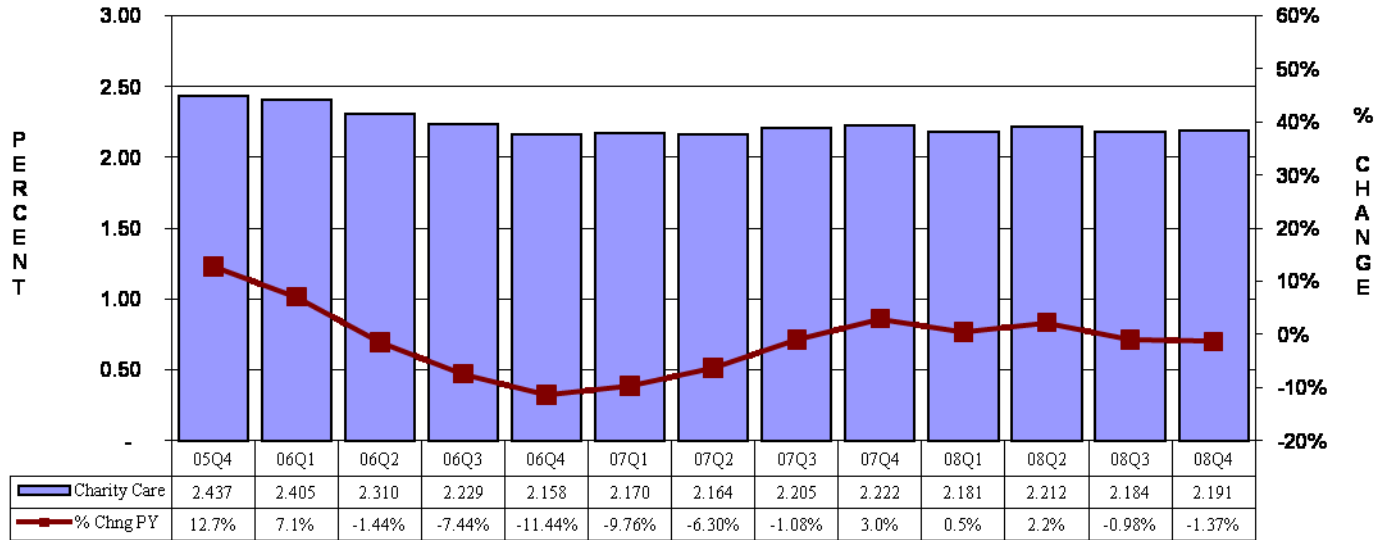
### Bad Debt as a Percent of Total Revenue



## Charity Care

The charity care proportion reached 2.19%, which was a decrease of 1.37% from the previous year.

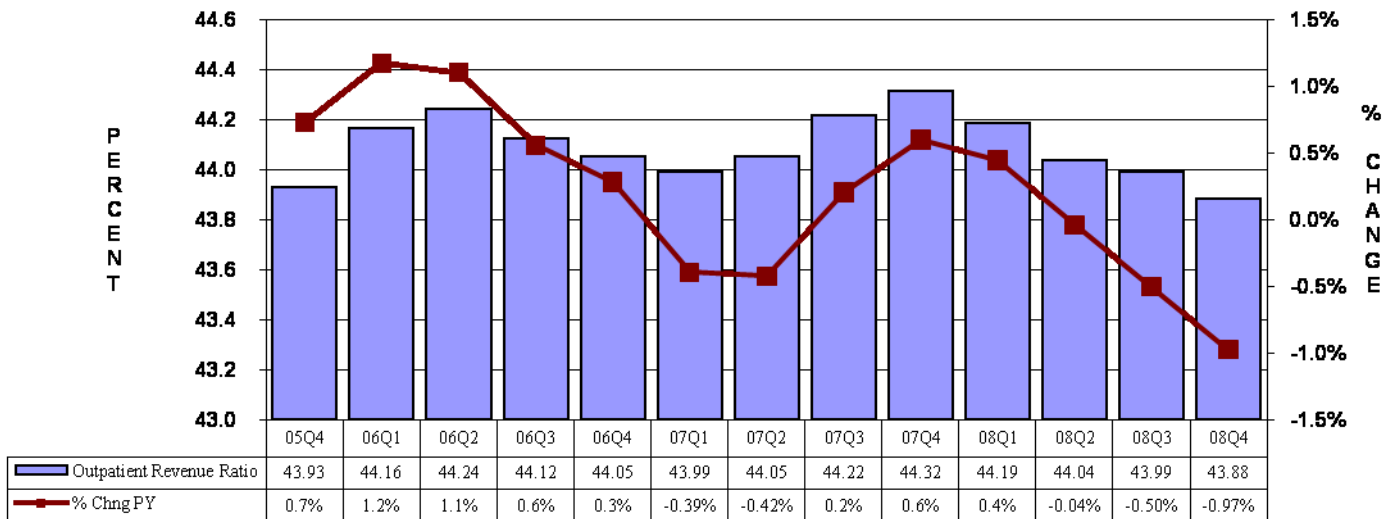
### Charity Care as a Percent of Total Revenue



## Inpatient and Outpatient Revenue

The outpatient revenue percentage is a way of looking at the relationship between inpatient and outpatient revenue. It is a rough indicator of the change in treatment locations. Between the annual periods, ended December 31, 2007 and December 31, 2008 the outpatient revenue percentage decreased from 44.32% to 43.88%, or 0.97%. As hospitals moved procedures from inpatient to outpatient setting over the years, the ratio has gone up dramatically. In 1987, the ratio was 24.2%. Recently the ratio has been between 43 and 45. The current quarter's ratio is the lowest ratio since the year ending September 30, 2005.

### Outpatient Revenue as a percent of Total Revenue

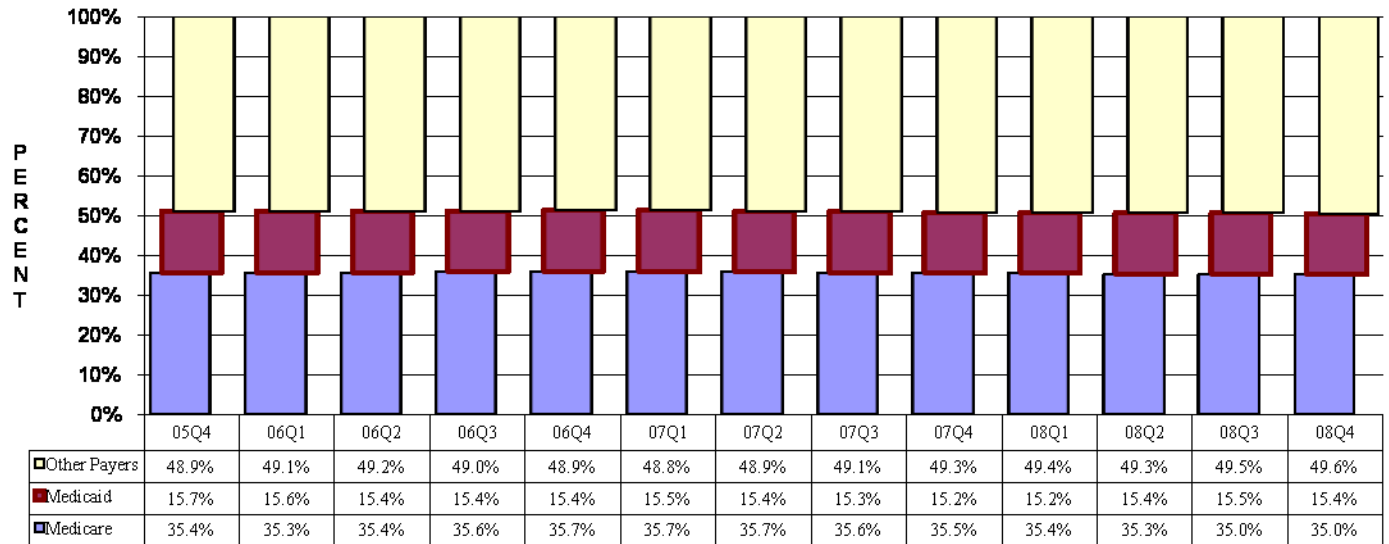


## Medicare, Medicaid and Other Revenue

The Medicare billed revenue percentage and the Medicaid billed revenue percentage indicate the proportion of total hospital business that these programs represent. In the four-quarter period ended December 31, 2008 the Medicare percentage was 35.02%, a decrease of 1.32% from the same period in 2007. The long-term trend it seems is that Medicaid is relatively steady around 15.5% while other seems to be slowing losing percentage points to Medicare. With 50.4% of total patient service revenue, the Medicare and

Medicaid programs have a major influence on the financial health of hospitals. Over the three-year period depicted in the graph below, the other payer portion has fluctuated within a tight band between 48.9% and 49.5%. The current value for other payer is 49.6%, the highest value since the year ending September 30, 2004.

**Revenue proportion by Payer**



HOSPITAL PERFORMANCE STATEWIDE	12 Mo. Ended December 31, 2007	12 Mo. Ended December 31, 2008	Total Change	Percent Change
Total Patient Revenue				
Inpatient	15,311,779,581	17,437,321,527	2,125,541,946	13.88%
Outpatient	12,183,786,054	13,634,750,220	1,450,964,166	11.91%
Total	27,495,565,635	31,072,071,747	3,576,506,112	13.01%
Medicare	9,757,182,003	10,881,278,196	1,124,096,193	11.52%
Medicaid	4,189,897,860	4,784,548,926	594,651,066	14.19%
Other	13,548,485,772	15,406,244,625	1,857,758,853	13.71%
Deductions From Revenue				
Contractual Adjustments				
Medicare	5,923,896,600	6,673,216,692	749,320,092	12.65%
Medicaid	2,576,783,991	3,085,530,867	508,746,876	19.74%
Other	6,170,354,039	7,069,530,714	899,176,675	14.57%
Total	14,671,034,630	16,828,278,273	2,157,243,643	14.70%
Charity	610,801,895	680,785,931	69,984,036	11.46%
Total	15,281,836,525	17,509,064,204	2,227,227,679	14.57%
Uncompensated Care				
Bad Debt	634,374,772	674,413,170	40,038,398	6.31%
Charity	610,801,895	680,785,931	69,984,036	11.46%
Total	1,245,176,667	1,355,199,101	110,022,434	8.84%
Net Patient Revenue				
Medicare	3,833,285,403	4,208,061,504	374,776,101	9.78%
Medicaid	1,613,113,869	1,699,018,059	85,904,190	5.33%
Other	7,378,131,733	8,336,713,911	958,582,178	12.99%
Total	12,213,729,110	13,563,007,543	1,349,278,433	11.05%
Other Operating Revenue	819,936,224	828,090,719	8,154,495	0.99%
Total Operating Revenue	13,033,665,334	14,391,098,262	1,357,432,928	10.41%
Total Operating Expenses	12,381,077,038	13,687,620,902	1,306,543,864	10.55%
Net Operating Income	652,588,296	703,477,360	50,889,064	7.80%
Non-Operating Income	263,329,258	(251,347,227)	(514,676,485)	-195.45%
Tax Revenue	32,989,168	30,576,993	(2,412,175)	-7.31%
Net Total Income	948,906,722	482,707,126	(466,199,596)	-49.13%
Gross Accounts Receivable				
Medicare	1,011,590,476	1,036,070,712	24,480,236	2.42%
Medicaid	782,603,832	808,507,979	25,904,147	3.31%
Other	2,793,490,239	2,944,661,519	151,171,280	5.41%
Total	4,587,684,547	4,789,240,210	201,555,663	4.39%
Days in Accounts Receivable				
Medicare	37.8	34.8	(3.1)	-8.16%
Medicaid	68.2	61.7	(6.5)	-9.53%
Other Payers	75.3	69.8	(5.5)	-7.30%
Statewide Total	60.9	56.3	(4.6)	-7.62%
Utilization				
Discharges	562,784	579,106	16,322	2.90%
Patient Days	2,413,853	2,526,518	112,665	4.67%
Length of Stay	4.29	4.36	0.07	1.72%
Adjusted Discharges	1,010,501	1,031,834	21,333	2.11%
Rates per Adjusted Discharge				
Total Revenue	27,209.83	30,113.45	2,903.61	10.67%
Deductions	15,123.03	16,968.88	1,845.85	12.21%
Net Revenue	12,898.22	13,947.11	1,048.89	8.13%
Operating Expense	12,252.41	13,265.33	1,012.92	8.27%
Net Margin	939.05	467.81	(471.23)	-50.18%
Financial Ratios				
Operating Margin	4.99	4.87	(0.12)	-2.36%
Total Margin	7.10	3.39	(3.71)	-52.29%
Deductible Proportion	55.58	56.35	0.77	1.39%
Contractual Proportion - Total	53.36	54.16	0.80	1.50%
Contractual Proportion - Medicare	60.71	61.33	0.61	1.01%
Contractual Proportion - Medicaid	61.50	64.49	2.99	4.86%
Contractual Proportion - Other	45.55	45.90	0.34	0.76%
Bad Debt Proportion	2.31	2.17	(0.14)	-5.93%
Charity Proportion	2.22	2.19	(0.03)	-1.37%
Uncompensated Care Proportion	4.53	4.36	(0.17)	-3.69%
Total Revenue/Inpatient Revenue	1.80	1.78	(0.01)	-0.77%
Outpatient Revenue Percent	44.32	43.88	(0.43)	-0.97%
Medicare Revenue Percent	35.49	35.02	(0.47)	-1.32%
Medicaid Revenue Percent	15.24	15.40	0.16	1.05%



## Notes:

### Information

For more detailed information you can visit the Department of Health - Hospital and Patient Data web site at <http://www.doh.wa.gov/EHSPHL/hospdata> for a large variety of hospital data and reports. Included are hospital financial data and reports, hospital discharge data and reports, and Charity Care reports. Also included are Directory of Hospitals, CHARS Procedure Manual, Accounting and Reporting Manual for Hospitals, Charity Care reports and past hospTRENDS.

Your comments and suggestions for improvement would be greatly appreciated. Please let us know what you like or do not like about the content and presentation of the hospTRENDS report. Contact information is on the last page.

### Background

All licensed hospitals in the State of Washington submit summary financial and utilization data to the Department of Health following each calendar quarter. Reported data are edited, summarized and analyzed by Hospital and Patient Data Systems staff. Specific data elements are defined in the Department's Accounting and Reporting Manual for Hospitals. Utilizing these data, various financial and utilization rates and ratios are calculated to enhance the description of the financial condition of hospitals in the state. The purpose of this series of reports is to provide information describing emerging hospital utilization and financial trends to all concerned parties.

Rather than focusing on individual calendar quarters, the data in this report are aggregated into twelve-month periods consisting of four calendar quarters each. This aggregation reduces the impact of seasonal fluctuations, which could distort actual trends occurring within the hospital industry.

The period covered by this report includes all four quarters of 2008. However, this preview is subject to change. The quarterly reports submitted by hospitals contain interim data that have not yet been subjected to audit review. Future adjustments and/or revisions because of both the hospital's internal accounting system review and the formal procedures of outside auditors may result in changes to previously submitted data. These future revisions will be reflected in the hospital's year-end reports. The year-end reports not only reflect audit adjustments but also provide substantially greater detail, which allows analysis of the information provided in greater depth.

## hospTRENDS

Washington State

Community Hospital Financial and Utilization Trend Newsletter

Quarter Ended December 31, 2008

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